

THE WHITE HOUSE

WASHINGTON

May 5, 1982

MEMORANDUM FOR THE PRESIDENT

FROM: THE CABINET COUNCIL ON ECONOMIC AFFAIRS

SUBJECT: The Federal Home Loan Mortgage Corporation  
Charter Act

Issue

The Federal Home Loan Mortgage Corporation (FHLMC), currently a government-sponsored financial institution owned by the Federal Home Loan Banks, has proposed legislation enabling it to increase its capital and expand its activities by selling stock to private investors. The administration must soon formally take a position on this legislation.

Background

The Federal Home Loan Mortgage Corporation (FHLMC), which is owned by the Federal Home Loan Banks (FHLBs), purchases home mortgages from thrift institutions and consolidates them into financial instruments which are sold in the nation's capital markets. This service allows thrifts to reduce the risks they incur when holding fixed interest rate securities during periods when interest rates are volatile. It also allows investors besides thrifts -- such as insurance companies and pension funds -- to invest in home mortgages, providing needed liquidity to the nation's housing markets.

Until now, the FHLMC has for all practical purposes functioned as a government agency. The initial funds used to commence FHLMC activities were provided by the FHLBs, which are nominally owned by private savings institutions but are supervised by the Federal Home Loan Bank Board (a government agency) and function essentially like government entities. A central issue for the administration and the Congress to consider is whether the FHLMC should continue to function as an essentially governmental institution, or whether its continuing expansion should require eventually privatizing the agency.

What the FHLMC Charter Act Would Do

The FHLMC Charter Act would allow the FHLMC to aggressively expand its program for packaging conventional mortgage-backed

-2-

securities by raising new capital from the private credit markets. The major provisions of the bill include:

1. Converting \$100 million of nonvoting common stock held by the 12 Federal Home Loan district banks to voting common stock.
2. Allowing the FHLMC to raise capital directly in the credit markets rather than by raising funds through the FHLB system.
3. Providing an emergency back-up from the FHLBs to the FHLMC of \$200 million.
4. Changing control of the FHLMC from the three members of the FHLBB to an expanded board of directors totalling nine members, three from the FHLBB and six elected by the shareholders.
5. Continuing an exemption for FHLMC securities from Securities and Exchange Commission (SEC) registration and related accounting and disclosure requirements, and allowing the use of the securities as "public deposits" for collateral purposes.

#### Cabinet Council Views on the FHLMC Chartering Act

The Cabinet Council on Economic Affairs, after considering the implications of the proposed legislation, unanimously decided to recommend opposing the FHLMC rechartering proposal, and to instead recommend that the administration encourage the FHLMC to consider legislation which would sunset its current Congressional charter. This approach would allow the FHLMC to expand its mortgage financing activities but only by severing all connections to the Federal Government.

The Council's recommendations are based on the following considerations:

1. Expanding the FHLMC's activities, while it is still closely linked with the Federal Government, would significantly add to the already excessive amount of federally assisted debt.
2. Enacting the FHLMC rechartering proposal would not result in truly privatizing the agency, but would instead expand a quasi-governmental institution.
3. With quasi-governmental status, the debt securities issued by the FHLMC will be accorded special preference

-3-

in the nation's credit markets, allowing the agency to raise money at lower costs than private institutions with similar missions and objectives. A number of banks and insurance companies have already entered or are considering entering the secondary mortgage services market. Providing the FHLMC with unfair competitive advantages over its private sector counterparts in the conventional mortgage market would discourage the development of a strong mortgage finance industry.

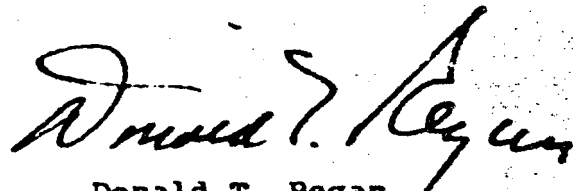
4. Expansion of the FHLMC, without true privatization, risks the creation of a government sponsored agency of such size and influence that its future problems may well complicate the sound conduct of economic policy.

The Subcommittee on Housing and Community Development of the House Banking Committee has already held hearings on the FHLMC proposal, and a mark-up is likely soon, possibly later this week. It is important that the administration announce its position on the legislation within the next several days.

Recommendation: That the administration oppose the Federal Home Loan Mortgage Corporation Chartering Act, but encourage the FHLMC to consider alternative legislation which would allow it to expand its operations as a completely private entity.

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Approve \_\_\_\_\_ Disapprove \_\_\_\_\_



Donald T. Regan  
Pro Tempore